Information from the Division of Health Care Finance and Policy

Quarterly Acute Hospital Financial Report, FY04 Q2

Overall profitability remained an issue for more than a third of the industry through FY04 Q2, and more than half of acute care hospitals continued to operate at a loss. Non-operating performance improved, with nearly all hospitals reporting Non-operating gains. In addition, the majority of hospitals were comfortably able to meet short-term obligations due to overall improvement in liquidity. However, long-term solvency remained a serious concern for more than a quarter of Massachusetts hospitals.

About this Report

The Division of Health Care Finance and Policy (the Division) publishes quarterly acute hospital financial reports in response to a legislative mandate to provide an annual assessment of financial trends in the acute care hospital industry. Quarterly reporting is one part of the Division's ongoing program to better protect the public interest by continuously monitoring the financial condition of acute care hospitals. This report presents an industry-wide analysis of FY04 through Quarter 2 (Q2).[1] Financial trends for individual hospitals are on each hospital's Fact Sheet at www.mass.gov/dhcfp.

Trends in financial ratio analysis can provide useful information about the hospital industry's financial condition. The three areas examined on a quarterly basis and discussed in this report are profitability, liquidity, and solvency.[2]

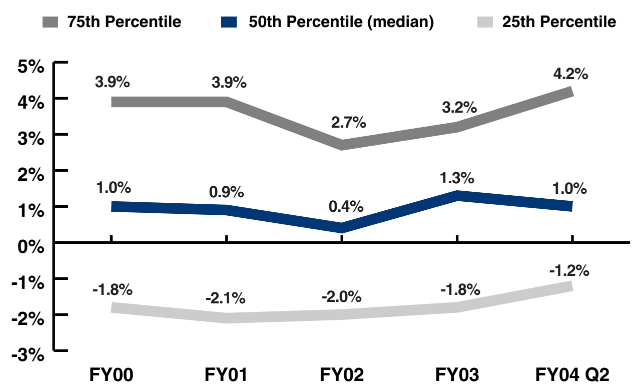
Profitability

Although most Massachusetts acute care hospitals are non-profit, they do need to generate a surplus in order to complete their missions, repay debt, and invest in the future of their organizations. Therefore, an analysis of the industry's profitability using three key ratios is reported here. Figures 1, 2, and 3 show FY00-FY04 Q2 trends for 25th, 50th (median) and 75th quartile values[3] for Total Margin,[4] Operating Margin,[5] and Non-operating Margin.[6]

During the first two quarters of FY04, the industry showed a slight improvement in overall profitability compared to FY03, with the upper quartile showing the most growth, increasing from 3.2% in FY03 to 4.2% through FY04 Q2 (see Figure 1). However, over a third of acute care hospitals reported total losses. These losses were largely attributable to weak operating performance for the lower and median quartiles (see Figure 2). Median Operating Margin showed a negative trend relative to FY03, and 52% of hospitals reported operating losses through FY04 Q2, compared to 46% in FY03. On a more positive note, increased Non-operating Margins across all quartiles mitigated operating losses for a number of hospitals (see Figure 3). As in FY04 Q1, 94% of the industry reported non-operating gains.

Figure 1

Total Margin Trend, FY00-FY04 Q2

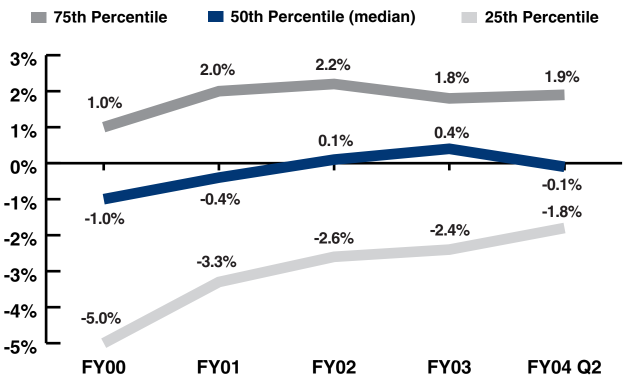


- **Lower and upper quartiles showed improvement in overall profitability, however, more than a third of the industry continued to experience total losses.**

Paul J. Cote, Commissioner • Division of Health Care Finance and Policy • 2 Boylston Street • Boston, MA 02116-4704
phone: 617-988-3100 • fax: 617-727-7662 • publications: 617-988-3125 • www.mass.gov/dhcfp

Figure 2

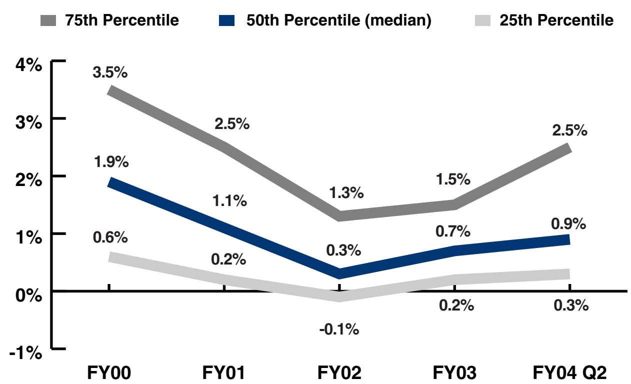
Operating Margin Trend, FY00-FY04 Q2



- **Although the upper and lower quartiles improved slightly, median Operating Margin fell below zero and more than half of the industry (52 %) operated at a loss.**

Figure 3

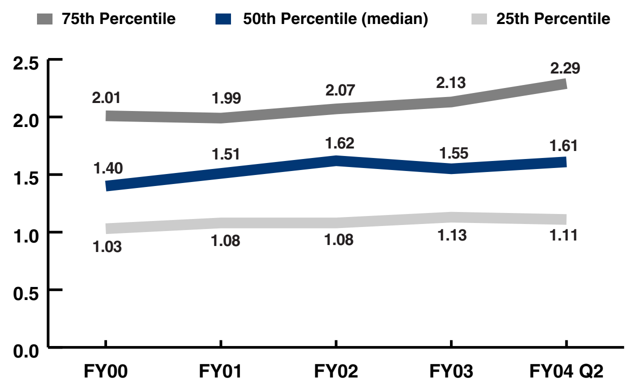
Non-operating Margin Trend, FY00-FY04 Q2



- **Fueled by improved market conditions, Non-operating Margins improved across all quartiles. Only 6% of the industry reported non-operating losses through FY04 Q2.**

Figure 4

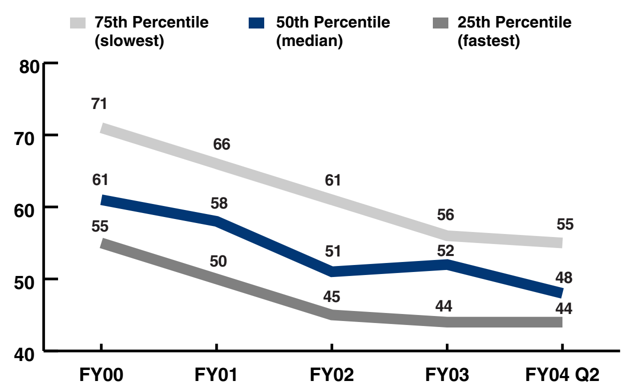
Current Ratio Trend, FY00-FY04 Q2



- **Current Ratio has remained relatively stable since FY00. A majority of hospitals (82%) maintained Current Ratios above the 1.0 benchmark through FY04 Q2.**

Figure 5

Days in Accounts Receivable Trend, FY00-FY04 Q2



- **Average Days in Accounts Receivable improved slightly compared to FY03, with median Days in A/R down by four days in FY04 Q2, thus continuing the industry's positive trend since FY00.**

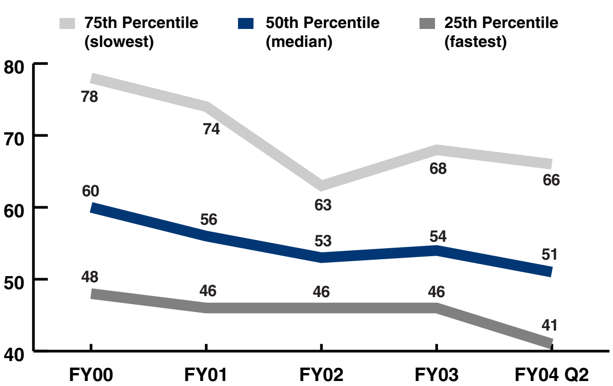
Liquidity

Liquidity ratios indicate a hospital's ability to meet its short-term obligations. Deterioration of these ratios is one indication of financial stress. Three liquidity ratios are reported here: Current Ratio,[7] Average Days in Accounts Receivable (A/R),[8] and Average Payment Period.[9] Figures 4, 5, and 6 show trends in quartile values for these three ratios.

Current Ratio, a measure of a hospital's ability to meet current obligations, improved for most of the industry; a majority of hospitals (82%) performed above the 1.0 benchmark through FY04 Q2.[10] However, the group of hospitals below the benchmark faced declining Current Ratio and weak operating performance, putting them at greater financial risk. During the first two quarters of FY04, hospital liquidity improved slightly relative to FY03 due, in part, to more efficient management of Days in A/R (see Figure 5). The average time it took hospitals to pay current liabilities (Average Payment Period) improved across all quartiles (see Figure 6), however, the decrease for the lower quartile hospitals should be viewed cautiously since they were paying current obligations at a faster rate than they were collecting payments.

Figure 6

Average Payment Period Trend in Days, FY00-FY04 Q2



- **Average Payment Period improved across the upper and middle quartiles. For the lower quartile, however, Average Payment Period was greater than Days in A/R.**

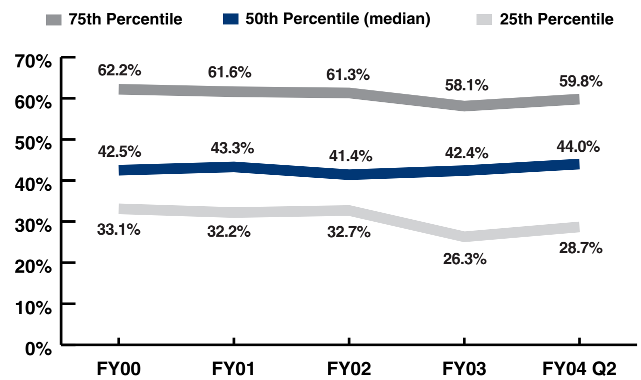
Solvency

Solvency ratios provide information regarding both how an organization finances its assets and how able an organization is to take on new debt. Deterioration of these ratios is another indication of problems in the financial health of an organization. The solvency ratios of Debt Service Coverage and Cash Flow to Total Debt are not included in this report because annualized data is necessary to accurately present these ratios. For quarterly analysis, only one solvency ratio is reported: Equity Financing.[11]

The equity financing ratio reflects the ability of a hospital to take on more debt and is measured by the proportion of total assets financed by equity. Low values indicate that a hospital is highly leveraged, and therefore may have difficulty using debt financing for further asset acquisition.[12] Equity financing for all quartiles improved slightly through FY04 Q2 compared to FY03 (see Figure 7). However, over a quarter of hospitals had equity financing ratios below the industry benchmark of 30%, indicating that a significant portion of hospitals were performing below standard and that long-term solvency remained an issue for these hospitals.

Figure 7

Equity Financing Trend, FY00-FY04 Q2



- **Equity Financing Ratios improved slightly for all quartiles through FY04 Q2. However, over a quarter of hospitals were below the 30% benchmark, indicating that financing future asset acquisition may prove difficult for much of the industry.**

Teaching versus Non-teaching Hospitals

The Division also examines the financial health of teaching and non-teaching hospitals using financial ratio analysis. The performance of 15 teaching hospitals and 50 non-teaching hospitals was analyzed. In the first two quarters of FY04, teaching hospitals outperformed non-teaching hospitals on profitability; both median Non-operating and Total Margins were higher for teaching hospitals. In addition, fewer teaching hospitals experienced overall losses. Non-teaching hospitals remained relatively stable with 40% experiencing negative Total Margins compared to 33% of teaching hospitals. Eight percent of non-teaching hospitals experienced non-operating losses, but as in FY04 Q1, no teaching hospitals experienced non-operating losses.

Non-teaching hospitals had a slightly stronger liquidity position compared to teaching hospitals in FY04 Q2.

Although Current Ratio was, on average, higher for teaching hospitals, a higher percentage (33%) of teaching hospitals reported Current Ratios below the industry benchmark of 1.0 (compared to only 14% of non-teaching hospitals). In addition, the majority of non-teaching hospitals exhibited slightly better values for collecting receivables due and paying current obligations.

Summary

During the first two quarters of FY04, more than a third of the industry reported overall losses; these losses were largely attributable to operating activities. Non-operating gains increased for all quartiles due to improved market conditions. As in FY04 Q1, only 6% of all acute care hospitals reported non-operating losses; all of these were reported by non-teaching hospitals. Liquidity improved compared to FY03 and the large majority of hospitals demonstrated the ability to meet current obligations. Improved liquidity was likely aided by improved collections of receivables. For more than a quarter of the industry long-term solvency remained a serious matter. Although Equity Financing improved for the least solvent hospitals (a positive shift to a five-year downward trend), current equity financing levels indicate that these hospitals are likely to have difficulty financing future asset acquisition.

Financial ratio values for each hospital are on the Hospital Fact Sheets at www.mass.gov/dhcfp. Hospital-specific dollar surplus or loss, net patient service revenue, total net assets, and assets whose use is limited are also provided on the Hospital Fact Sheets illustrating the magnitude of hospital surplus and loss, the size of operation, and the size of reserves.

---

1 The findings in this report are based on the financial filings of all 65 reporting acute care hospitals. Salem and Union hospitals are no longer reported individually since North Shore Medical Center now includes both Salem and Union Hospital information. Boston Medical Center was not included in this analysis since Q2 data were unavailable. Three hospitals (Mercy, MetroWest, and St. Vincent) have a fiscal year that ends on December 31, thus their most recent filings represent the first three months rather than the first six months of FY04. Martha's Vineyard's fiscal year ends on March 31, thus its most recent filing represents 12 months of FY04. Cambridge Health Alliance's fiscal year ends on June 31, thus its most recent filing represents nine months of FY04.

2 Depending on the organization of each hospital, data may exclude other aspects of some hospitals' financial health, such as performance of endowments or the financial health of parent or other affiliated organizations.

3 Quartile values can shed light on information about the distribution of financial ratio values across hospitals. Often, averages can be materially affected by outlier/extreme values at the low and high ends of a distribution. Examining quartiles, therefore, is a preferred means of assessing the overall distribution of values across hospitals. For instance, the ratio values of one quarter of the hospitals at the low end of the distribution will fall at or below the 25th quartile value. Similarly, the ratio values of one-quarter of the hospitals at the high end of the distribution will fall at or above the 75th quartile value. The 50th percentile is the median, or the center of the distribution of values. Half of the hospitals' financial ratio values will fall below the median, and half will fall above the median. These quartile measures are particularly useful when a distribution is markedly skewed, or where it is generally symmetrical but includes a few outliers.

4 Ratio of total income to total revenue.

5 Ratio of operating income to total revenue.

6 Ratio of non-operating income to total revenue.

7 Ratio of current assets to current liabilities.

8 Ratio of net patient accounts receivable to net patient service revenue/quarters of data * 91.25.

9 Ratio of current liabilities less estimated third-party settlements to total expenses less depreciation and amortization/quarters of data * 91.25.

10 A Current Ratio value of 1.0 indicates that a hospital has one dollar held in current assets per dollar of current liabilities. Values below 1.0 are considered unfavorable.

11 Ratio of total net assets to total assets.

12 William O. Cleverly, Essentials of Health Finance, Fourth Edition, Copyright @ 1997 by Aspen Publishers, Inc.

Publication Number: C.R. 1063